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E. & J. GALLO WINERY
REGULATORY AFFAIRS & COMPLIANCE DEPARTMENT — TELEPHONE 209-341-3391; FAX 209-341-1561

October 20, 2003

Chief, Regulations and Procedures Division
Alcohol & Tobacco Tax & Trade Bureau
P.O. Box 50221
Washington, D.C. 20091-0221

RE: TTB NOTICE No.4. FLAVORED MALT BEVERAGES & RELATED PROPOSALS

Ladies/Gentlemen:

This letter contains the comments of E. & J. Gallo Winery on the regulatory proposals in TTB Notice No. 4.

In a notice published in the June 2, 2003, Federal Register, the Alcohol and Tobacco Tax and Trade Bureau extended the deadline for comments on this notice to October 21, 2003. This extension was based on E. & J. Gallo Winery's request for additional time to conduct a study involving the aging of reformulated products under normal conditions to determine the impact of the proposed changes to the malt beverage alcohol source standards on Winery flavored-malt-beverage products. The TTB also noted that the additional time would give other commenters time to conduct studies on their products.

E. & J. Gallo Winery conducted a study on two of its thirteen flavored-malt-beverage products—Bartles & Jaymes Original and Berry Flavored Malt Coolers. The Winery's current formulation for those products was compared with the alternative formulations proposed in Notice No. 4. One alternative had 51% of the alcohol derived from the malt base, and the other alternative had flavors contributing no more than 0.5% alcohol by volume to the final product. Due to the limited time available, the Winery was only able to evaluate these products as they would be under normal shipping and storage conditions three and one-half (3½) months after production.

After reviewing the results, the Winery has determined that the study was inconclusive. It appeared that each of the two products we investigated were impacted differently by the change in malt percentage. The indication is that all of our products must be studied individually to understand the full impact of the proposed change. There was no time to explore this issue in time for these comments. In addition, due to the time needed to properly handle, ship, and distribute flavored malt beverages, even product aged three and one-half months is not representative of the age of most product consumed. Much more time would be necessary in order to yield results useful to

P.O. BOX 1130, MODESTO, CALIFORNIA 95353 TELEPHONE (209) 341-3111

Alcohol & Tobacco Tax & Trade Bureau
October 20, 2003
Page 2

support any position on the proposed flavored-malt-beverage formulation standards. Consequently, while the Winery greatly appreciates the TTB's granting the additional time to conduct the study, the Winery has decided not to submit the study results in these comments.

The Winery is submitting its comments in response to TTB's specific requests as indicated below.

1. The proposed amendments to our regulations relating to the production, labeling, and composition of products marketed as flavored malt beverages and the proposed definitions for beer and malt beverages requiring these products to be composed primarily of alcohol from fermentation and that limit the contribution of alcohol from added flavors or other ingredients containing alcohol to less than 0.5% alcohol by volume:

In light of the inconclusive results from the study, the Winery is taking no position on the proposed definitions for beer and malt beverages. We do have comments on other parts of the proposed rule.

2. The proposed requirement that malt beverages containing alcohol derived from added flavors or other ingredients containing alcohol bear a mandatory alcohol content statement on their brand labels:

The Winery supports TTB's proposal to require alcohol content statements on flavored malt beverages with two provisos:

~ The requirement should extend to all malt beverages, not just flavored malt beverages, and

~ The requirement must remain optional at this time due to existing bans in New York and Oklahoma.

Like most other brewers, the Winery has two versions of each malt beverage label-one with an alcohol declaration and a second without. The label with no alcohol declaration is used in New York, Oklahoma, and a number of other states in order to allow for economical bottling runs. In states with no requirement, either label may be used depending upon inventory levels.

3. Whether products currently on the market could be made under our proposed standard or under an alternative standard and the amount of time required to comply with any new restrictions on adding alcohol to beer and malt beverages:

Alcohol & Tobacco Tax & Trade Bureau
October 20, 2003
Page 3

The Winery plans to continue to produce and market flavored-malt-beverage products if TTB enacts either proposal described in Notice No. 4. However, the Winery requests that TTB allow one year for industry members to bring their products into compliance with any such new standard.

Either new standard would require the Winery to invest in new equipment to produce the additional volumes of malt base required to produce its malt-based products. The Winery contemplates that it might need to increase its production of malt base by as much as eight times (8X) the current level.

Either standard would also force the Winery to develop new malt fermentation techniques and production technologies to produce a malt base that results in products with a flavor and taste profile that meets current consumer expectations for such products. This might require development of new technology and different equipment from that now used to ferment and produce the malt base.

The Winery would also like sufficient time to evaluate and experiment with the shelf life and consumer acceptance for its new formulations. As stated above, the Winery's study of the effect of the alternative formulations yielded inconclusive results. We believe that comments submitted by other parties will demonstrate that changing the standard for flavored malt beverages requires a complete re-evaluation of the product formulation and flavor use.

As noted above, even if the Winery's study had been more useful, it only applied to two of the Winery's thirteen current Bartles & Jaymes products. In addition, the Winery expects to introduce new Bartles & Jaymes flavors in the near future. These other products have, or will have, different formulations from the Original and Berry-Flavored products included in the study. We are going to need several months to study the impact of changing malt percentages on our entire product line to learn how various flavor systems react.

For all of these reasons, the Winery believes that allowing a full year for the industry to adjust to the new standards would give it and the other affected industry members adequate time to study the impact of the new standards on the formulations for all of their products and to produce new formulations that meet consumer expectations.

4. The new formula filing requirements for brewers and importers who wish to produce or import beer or malt beverages containing added flavors, added colors, or which undergo processing not customary in the production of traditional beers:

The Winery endorses TTB's proposal to change the process for approving flavored-malt-beverage products from statements of process, which are part of the plant registration, to formulas that are independent of the plant registration. The Winery has advocated this approach for many years. As noted in the preamble, the TTB proposal provides no form for the formula submissions. We suggest that the form currently used for flavored wine products be adapted to serve for flavored malt beverage formulas with appropriate changes to the heading and instructions.

Alcohol & Tobacco Tax & Trade Bureau
October 20, 2003
Page 4

There are two elements in the proposed regulation for formulas that concern us:

1) Paragraph (a)(3)(ii) requires formulas that include the use of ingredients containing alcohol to explicitly indicate: "The maximum volumes of the flavoring materials or other ingredients to be used;... ." There are many instances in which an industry member might want to specify two or more flavors to be used alternatively or in combination to achieve the intended effect. For example, the industry member might need the ability to move from one flavor to another due to pricing changes for ingredients or acceptance of ingredients in other countries. In this event, the formula needs to allow a maximum amount for each flavor that assumes minimal use of the alternative flavor(s). The actual amount used would be less when the alternative flavor(s) is(are) used in greater quantities.

To use a hypothetical example, Flavor A and Flavor B each would have an individual use rate of 1 % of the total beverage volume. When used together, only 0.5% of each is required. Each flavor has an alcohol content of 50% by volume. Thus, when used alone, the flavor contributes 0.5% of the alcohol in the final product, and when used together, the combined contribution is also 0.5%.

Example 1:

A formula for 100 gallons could look like this:

Item 1: 0 – 1 gallon of Flavor A with 50% alcohol by volume, and/or
0 – 1 gallon of Flavor B with 50% alcohol by volume,
Item 2: etc.

Example 2:

Another formula for 100 gallons might look like this:

Item 1: 0 – 0.5 gallon of Flavor A with 50 % alcohol by volume
Item 2: 1 –3 gallons of Flavor A Complement with 0% alcohol by volume
Item 3: 0.5 – 1 gallon of Flavor B with 50% alcohol by volume

In the first example, Flavor B may be used in place of Flavor A or both flavors may be used in combination. In the second example, the use levels of Flavor A and Flavor A Complement are driven by availability and price issues. Flavor B is used to provide balance for the varying levels of the first two flavors. In both examples, flexibility is being built into the formula to avoid frequent formula refiling based on flavor pricing or availability. An example would be today's Vanilla market, which is highly volatile.

If an ALFD examiner simply added up the maximum levels in the above examples, she or he might conclude that the alcohol contribution from the flavors exceeds the amount allowed by proposed § 25.15. To counter this erroneous conclusion, an industry member could be required to include in the formula a condition that the total amount of alcohol contributed by flavoring material will not exceed the limit set at § 25.15.

Alcohol & Tobacco Tax & Trade Bureau
October 20, 2003
Page 5

2) Subsection (c) states; "You must state the alcohol content of the fermented product at each step in production after fermentation, and the alcohol content of the finished product." We think this requirement is overly restrictive and will have unintended consequences for both Brewers and the TTB:

a) Compliance with this provision would require very complex formulas and consequently very complex records to prove compliance with the formula. It would also require breaking up the processing of a formula to allow taking of samples and performing analyses between each step to obtain the information required to show compliance with the formula. We submit that this level of detail is not needed since the limitation given in proposed § 25.15 applies to the final product, not each intermediate step.

b) In addition to the excessive level of detail required by subsection (c), it would also eliminate the ability of industry members to streamline their operations by changing the sequence of additions in response to changing conditions. Also, industry members might combine ingredients prior to addition to the final blend.

c) Finally, this provision would lock industry members into batch processing at a time when all industry members are seeking to improve the efficiency of their operations. For example, one way to improve efficiency is in-line blending. This technology is currently employed in the beverage industry and is being investigated for use in the brewing industry. The TTB proposal would effectively foreclose all opportunity to use this technology.

5. While we believe that our proposal is consistent with the definitions in the Internal Revenue Code and the FAA Act, flavored malt beverages that contain a significant amount of added alcohol may not have been contemplated by Congress at the time of the statutes' enactment. Therefore, we also seek comments on whether Treasury and TTB should seek legislation that would specifically address the treatment of such products and whether such legislation is necessary to avoid unintended economic consequences of the application of the statute under this rule.

The Winery has no position as to whether TTB should seek an enabling statute. However, the economic consequences of changing the standards applicable to flavored malt beverages would occur regardless of whether the changes are enacted by regulation or by statute.

Please contact the undersigned if you have any questions about these comments.
Very truly yours,

E. & J. GALLO WINERY

Paul C. Thorpe
Attorney in Fact